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FINANCIAL MARKET SNAPSHOT

Recharged in July

August 4, 2020

Global equity and credit market returns picked up steam in July as investors shook off high valuations and focused on news of a pending Covid-19 vaccine.

Federal Reserve policy comments likely furthered the notion that the authorities would support markets should conditions deteriorate.

Additional steps toward a Covid-19 vaccine and further speculation on an eventual economic recovery again had investors buying stocks with both hands. After slowing down a bit in June, gains in risky asset prices picked up steam again in July. This despite some recent hiccups in U.S. data that showed an economy again suffering from state-by-state curbs on economic activity. Meanwhile, the virus lockdowns have seemingly pulled forward the digitization of society by several years, leading investors to flock further into tech stocks while largely shunning more traditional firms. Valuations in technology stocks, and other sectors, continued to rise.

Corporate earnings, targeted to be down 35% in Q2, have perhaps not been as bad as some had feared. So far, 80% of S&P 500 companies have beaten lowered estimates. Despite the fundamental hurdles, equity investors kept their balance by leaning heavily on low interest rates and the hope of more policy support. The Fed again said it was going to keep rates low, although fiscal leaders have yet to follow through on expected stimulus.

Table 1: Notable Returns / Yields / Spreads: Apr. '20 - Jul. '20

Source: Bloomberg

Note: BBG Barc = Bloomberg Barclays; 10Yr Treasury Yield figures as of the end of the month
High Yield Corp Spreads = Yield-to-Worst differential vs. 10Yr Treasury (end of month)

	Apr '20	May '20	Jun '20	Jul '20
S&P 500 Index	12.80%	4.76%	1.98%	5.63%
MSCI EAFE Index	6.61%	4.41%	3.45%	2.36%
MSCI Emerging Markets Index	9.18%	0.79%	7.36%	9.01%
BBG Barc U.S. Aggregate Bond Index	1.78%	0.47%	0.63%	1.49%
10-Year Treasury Yield	0.64%	0.65%	0.66%	0.53%
U.S. HY Corp Spread (10Yr)	7.43%	6.37%	6.19%	4.84%

U.S. credit markets continued to rally through July. Both U.S. investment grade and high yield credit spreads came in (bond prices moved higher). Investment grade spreads moved back toward pre-crisis levels, while high yield spreads stayed a bit wider as rising default rates loomed. U.S. Treasury yields remained depressed as the 10-yr benchmark closed the month at 0.53%; a new all-time low. Finally, gold rose dramatically through the month (+11%) as the dollar weakened and buying momentum prevailed.

Economically, manufacturing and services sector activity continued to show halting improvement, although the new round of economic rollbacks in

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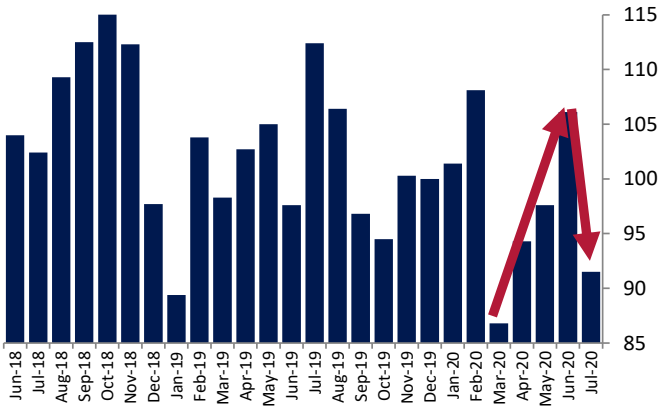
some states has cooled things off a bit. This dynamic can be most readily seen in U.S. consumer confidence and retail sales numbers. Consumers, approximately 70% of the U.S. economy, felt good about the April/May re-openings, but have responded with less gusto given the June/July rollbacks of previous economic privileges.

Figure 1: U.S. Consumer Confidence
Source: Conference Board



Consumers have been a bit less optimistic now that some state governments have curbed their re-openings.

Meanwhile, the presence of central bank policy support has apparently created a market where investors feel emboldened to take unbridled risk; with the knowledge that policymakers may be compelled to throw them a life-line should conditions deteriorate. With the S&P 500 Index trading at a 25% premium to its 10-year trailing P/E average, it is evident that risk-taking momentum is running high. And while valuations are not often seen as a market timing tool, current levels have typically marked historic "I told you so" moments.

As a result of high valuations and what we believe are some examples of market excesses, we have embarked on a more cautious approach since the Q2 credit and equity gains. We have rolled back credit market allocations and we have instituted more low-beta equity exposure to offset what we believe is the growing risk of a market correction.

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